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IN THE

Supreme Court of the United States

MCLANE WESTERN, INC.,
Petitioner,

v.

DEPARTMENT OF REVENUE, STATE OF COLORADO, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the Colorado Court of Appeals, Division IV

BRIEF OF *AMICI CURIAE* COUNCIL ON STATE TAXATION, THE NATIONAL ASSOCIATION OF WHOLESALER DISTRIBUTORS, AND THE NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether the Colorado excise tax, which varies based on whether the underlying economic activity occurs in-state or out-of-state, violates the Commerce Clause of the Constitution, U.S. Const. Art. I, § 8, cl.3.

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This brief is filed, with the written consent of the parties lodged with the Clerk of this Court, on behalf of the Council On State Taxation, the National Association of Wholesaler Distributors, and the National Association of Manufacturers as *amici curiae* in support of petitioner. Between the three *amici curiae* that have joined to file this brief, every major industry is represented.[1]

[1] No counsel for a party authored this brief in whole or in part, and no person or entity, other than *amici curiae*, has made a monetary contribution to the preparation or submission of this brief. Written consent of all parties have been obtained and filed with the Clerk of the Court.

INTEREST OF *AMICI CURIAE*

Description of Associations Filing as Amici

The Council On State Taxation ("COST"), is a non-profit trade association formed in 1969 to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST represents nearly 600 of the largest corporations in the United States, including companies from every industry segment. COST's membership conducts business in every state and between every state. The membership pay tax in every state and are concerned when states or localities seek to circumvent this Court's application of Constitutional limitations on their ability to discriminate against interstate commerce. COST's mission is to preserve and promote equitable and nondiscriminatory taxation of multistate businesses. Thus, COST members, and the organization itself have a financial and organizational interest in whether the Colorado excise tax is unconstitutional.

The National Association of Wholesaler-Distributors ("NAW") is a non-profit trade association that represents the wholesale distribution industry. NAW is comprised of direct member companies and a federation of more than 100 national, regional, state and local associations and their member firms which, collectively, total approximately 40,000 companies operating at some 150,000 locations throughout the nation. NAW's members are a constituency at the core of the U.S. economy—the link in the marketing chain between manufacturers and retailers as well as commercial, institutional and governmental end-users. While industry firms vary widely in size, wholesaler-distributors generally are small to medium-size, closely-held businesses providing stable, well-paying jobs to more than 5 million Americans and account for some $3.6 trillion in annual economic activity in 2005. Nearly all of NAW's members are engaged in interstate commerce, and thus even those members who are not directly affected by the Colorado excise tax at issue, will

benefit from, and are entitled to, the positive business environment ensured by the Commerce Clause of the United States Constitution.

The National Association of Manufacturers ("NAM") is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media and the general public about the vital role of manufacturing to America's economic future and living standards. The members of NAM thus also have a financial interest in whether the Commerce Clause protects its members from discriminatory taxation by the states.

Description of Amici Interest

While the particular tax at issue in this case is a narrow excise tax applicable only to the distribution of tobacco products other than cigarettes, the decision of the Colorado Court of Appeals could affect a far broader range of taxes and taxpayers if its rationale is allowed to stand. The Colorado court's decision in this case, if left unchecked, provides a roadmap for discrimination against interstate commerce for practically all methods of state and local taxation. It is this risk of application beyond the specific tax at issue that has caused significant concerns for the *amici* and motivated the *amici's* contribution to this case. *Amici*, as national organizations, have a unique perspective on the wider applications and implications that the reasoning by the Colorado court could have on other industries, other taxpayers, other tax regimes, and other state and local governments. *Amici* also seek to bring to this Court's attention the importance of resolving this issue before it spreads. It has been the unfortunate experience of *amici* and *amici's* members that many states have a significant reluctance in remedying unconstitutional taxes. Because

of *amici's* experience with this historical reluctance, *amici* have an interest in seeing this issue resolved expeditiously. In sum, *amici* have both an interest in this case to prevent stealth discrimination against interstate commerce from proliferating and a national and multi-industry expertise to discuss relevant matter not already brought to this Court's attention by the parties.

SUMMARY OF ARGUMENT

The Colorado excise tax unconstitutionally varies based on whether the underlying economic activity occurs in-state or out-of-state. As products subject to the tax move from manufacturing to retail sale, the Colorado tax increases in amount if these processes take place outside the state but not if the processes take place in the state. By structuring the tax to apply when the product enters the state (as opposed to a tax on unit, weight, value or on the ultimate sales price as is done in innumerable other tax structures) Colorado has created a tax that discriminates against interstate commerce while appearing facially neutral.

Unchecked, the Colorado Court of Appeals' decision provides a ready roadmap for states to convert constitutional taxes into taxes that discriminate against interstate commerce. Further, even taxes found unconstitutional by this court and others could be revived using the Colorado model. In either case the decision gives a blueprint for states to impose a tax burden on interstate commerce without imposing the same burden on their own.

Lastly, delay in resolving this issue will inevitably lead to an unnecessary financial crisis for state governments and exponential growth of the illegal tax on interstate commerce. A denial of certiorari in this case will encourage states to rely on an unproven and suspect tax structure which, if eventually reviewed by the U.S. Supreme Court, should be struck down as unconstitutional. Delaying what *amici* believes to be in-

evitable will expose state tax receipts to claims for refund and thus create uncertainty for taxpayers and state government alike. In a very real way the Court has the ability to prevent the roof from falling in before state governments build their houses on unstable grounds.

ARGUMENT

I. Under the Commerce Clause of the United States Constitution, the Colorado excise tax unconstitutionally discriminates against interstate commerce because the net result of the tax regime is a higher tax on items purchased from manufacturers, wholesalers, and distributors located outside of Colorado than the tax on items purchased from such businesses operating within Colorado.

The question presented in this appeal is whether the Colorado excise tax, which varies based on whether the underlying economic activity takes place in-state or out-of-state, violates the Commerce Clause of the Constitution, U.S. Const. Art. I, § 8, cl.3. The ramifications of this appeal however, are not limited to the tax type, tax jurisdiction, or taxpayer involved. Because the decision below creates a roadmap for discrimination it is critical that the U.S. Supreme Court review the tax structure before it is adopted by other states to in an effort to export their tax burden. Such review will help minimize fiscal disruption and uncertainty for states and taxpayers alike.

Colorado's excise tax violates the Commerce Clause because its impact is to impose a greater tax on products manufactured and distributed from out-of-state than it does on products manufactured and distributed in-state. Decades of U.S. Supreme Court precedent, including *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), hold that under the Commerce Clause a state may not discriminate in its tax system in favor of local companies over out-of-state companies.

The Commerce Clause of the United States constitution provides that Congress shall have the authority to "regulate commerce . . . among the several states." Art. I, §8, cl. 3. This affirmative grant of power has given rise to a concomitant negative or dormant implication—the states may not discriminate against interstate trade. *Associated Industries v. Lohman*, 511 U.S. 641, 646 (1994). The dormant element of the Commerce Clause thus prohibits economic protectionism on the part of states. States may not adopt measures designed to benefit in-state economic interests by burdening out-of-state competitors. *Id.* at 647. Thus, a state may not tax a transaction or incident more heavily when it crosses states lines than if it were to occur entirely within one state. *Id.* Economic protectionism can be made out by a showing of either discriminatory effect or discriminatory intent. *Bacchus Imports Ltd. v Dias*, 468 U.S. 263, 270 (1984).

Petitioner McLane is indeed subject to a greater tax burden by Colorado as a direct result of its interstate trade. The tax at issue here is an example of a violation of the Commerce Clause through a discriminatory effect instead of a discriminatory purpose. Petitioner is a distributor of smokeless tobacco products within Colorado known as OTP ("other tobacco products"). Petitioner buys OTP from an out-of-state distributor and then resells the products in-state. The Colorado tax at issue in this case is an excise tax that is imposed on the sale, use, consumption, handling, or distribution in the state of all OTP tobacco products. Colo. Rev. Stat. §39-28.5-102(1). However, the tax is imposed once and only once on the first Colorado distributor, which means the first distributor in Colorado to receive the OTP. *Id.*

The crux of this case, and the reason that the excise tax is clearly invalid, lies with the fact that the more activity that occurs in the distribution chain of the OTP *outside* of Colorado the higher the cost of the OTP due to mark-ups. Thus, a higher tax base leads to a higher eventual tax paid by

Petitioner. If the entire distribution chain were located *inside* of Colorado, the same combined excise tax would be owed by the original manufacturer (here UST Manufacturing), but would be owed on a much smaller tax base because the tax is calculated earlier in the distribution chain. This is called a 'shifting tax base' because the amount included within the tax base depends on when the product enters the state.

The end result of the Colorado tax, and the Colorado Court of Appeals interpretation of it, is to discriminate against inter-state commerce in favor of intra-state (i.e. Colorado only) commerce. This violates the Commerce Clause and the Supreme Court's decision striking down discrimination based on a shifting tax base in *Halliburton*. *Halliburton Oil Well Cementing Co. v. Riley*, 373 U.S. 64 (1963). The ruling on the Colorado tax is especially pernicious because it could just as easily apply to any sort of state tax. For instance, sales, use, income, property, and excise taxes could each be reconfigured based on the Colorado court's rationale.

If the analysis of the Colorado court is acceptable, any state wishing to give a discriminatory boost to its in-state companies could simply switch its tax base to one which depends on when the good or activity taxed first occurs in the state. For example—the sales tax is a widely adopted transaction tax imposed on the final sale to the ultimate consumer of tangible personal property (and some services). Typically, the sales tax is collected by the retail vendor but paid by the vendor's customer. It would clearly be unconstitutional for a state to impose a higher sales tax rate on items manufactured in other states than items manufactured in the taxing state (e.g. a 5% rate for non-Colorado manufactured goods and a 1% rate for Colorado goods). However, under Colorado's theory of the Commerce Clause, a switch in the collection point for a sales tax could accomplish just such a rate differential. If a state imposed the sales tax not on the *final sale* but instead on the *first sale that occurred within the state* but still provided that

the tax would be passed through and paid by the ultimate consumer, the tax would be "constitutional" under the Colorado court's analysis but clearly unconstitutional under this Court's Commerce Clause jurisprudence because it achieves the same result as imposing a higher tax rate on goods manufactured out of state.

The practical (and unconstitutional) result of taxing goods manufactured out of state more than goods manufactured in state in this hypothetical occurs because of the economic reality that sales prices increase throughout the taxable good's distribution chain from manufacturer, through wholesalers and distributors, to the final retailer and customer since each stage of the distribution chain adds value and requires a profit. As an example, assume a manufacturer sells to a distributor a product for $100; the distributor will sell that good to a wholesaler for $110; the wholesaler will sell the good to a retailer for $120; and the retailer will sell the good to the final customer for $150. Further, assume a hypothetical tax rate of 10%. Thus, under the hypothetical tax imposed on the first sale in the state as described above, if the manufacturer of a taxable good is in the taxing state, the first sale of that taxable good would occur when that manufacturer sold the product to a wholesaler, retailer, or other distributor. This price would in almost all cases be less than the final retail price. In our example, the taxable price would be $100 and the tax on such a sale would be $10 ($100 tax base x 10% tax rate). Under the hypothetical tax, that tax would be added to each subsequent receipt until ultimately paid by the final consumer. However, for an out-of-state manufacturer, wholesaler, distributor, and retailer selling goods at the same price, the tax passed through to the final customer will be much higher. If all elements of the distribution chain take place outside of the state except for the final sale by the retailer to the customer ($150 sales price in our example) then the first sale occurring in the state will be that final sale to the ultimate customer. At a tax base of $150, even with an allegedly non-

discriminatory 10% tax rate, the customer purchasing goods made and sold out of state will pay a sales tax of $15 as opposed to the tax of $10 if the manufacture and distribution activities had occurred in the state. Thus, from the customer's, and actual taxpayer's, point of view, the transaction and the product are exactly the same but the final tax is drastically different. Economically, the result is exactly the same as if the state had imposed a typical sales tax on the final sales price but imposed a tax rate of 10% for locally manufactured goods but 15% for goods from other states. This creates a significant incentive for retailers to purchase from in-state companies from which the tax has already attached—a classic sign of a tax which discriminates against interstate commerce.

If this hypothetical sales tax example is not enough to convince this Court of the very real risk of the widespread discrimination potential of the Colorado court's ruling, another potential scenario can also be posited. The Colorado tax at issue is really no different from a retail tobacco tax with a tax credit to tobacco retailers purchasing products from in-state manufacturers and distributors. If the Colorado tobacco tax were imposed not on the first use in the state but instead on all retail sales in the state, the tax base would be the same for all tobacco purchases. If a tax credit were provided to retailers buying from local manufacturers for the tax on the difference between the manufacturer's sales price and the final retail sales tax, the financial result and burden of the tax would be exactly the same as Colorado's current scheme. However, it seems abundantly clear that a tax credit only for purchases from in-state manufacturers/distributors would violate the discrimination prong of the Commerce Clause. If the Colorado court's opinion is allowed to stand, states will be able to achieve the equivalent of an unconstitutional tax credit for purchases from in-state manufacturers, except that the states will have to go through the inefficient hoops blessed by Colorado. The result is both a tax that unconstitutionally

discriminates against interstate commerce and a very complicated and inefficient tax imposition system.

II. The Potential Reach of the Colorado Court's Analysis and Past Experience With States' Inability or Unwillingness to Promptly and Completely Remedy Discriminatory Taxes Suggest that It is Prudent for This Court To Promptly Address the Issue.

While for many sensible and judicious reasons, this Court is cautious in accepting cases for which there has not been significant attention given by several other courts, it is important that the Court act now in this matter to forestall problems that might arise if the States, after enacting a broad but discriminatory tax following Colorado's model, must ultimately eliminate the tax after it is struck down by this or some other court. The risk of future problems, both for states and taxpayers, is not mere fear-mongering but is based on painful and frustrating past experience. State legislatures enact unconstitutional taxes for as many reasons as there are state legislators. Whether because of time constraints, budget limitations, misunderstanding, or willful disregard, state legislatures have always and appear to continue to enact tax statutes that unconstitutionally discriminate against interstate commerce. The real problem occurs, however, in the states' failure and inability to properly and fully grant real relief to taxpayers that suffer real economic injuries from such discrimination once the unconstitutionality of the action is pointed out by a judicial authority. States use many devices to delay, sometimes, indefinitely, the day of reckoning. Delay itself can frequently deny an injured taxpayer a true remedy.

It is not just taxpayers that can be injured by a delay in determining whether a tax is unconstitutional. States rely on the revenue stream from the taxes assessed and on the books. States are required to maintain a balanced budget each year so

any shortfall must be accommodated quickly and fully. While states can offer a variety of remedies to aggrieved taxpayers to avoid financial crisis in the budget—such as tax credits in lieu of refunds, installment refunds, and pre-deprivation hearing opportunity—each of these alternatives still affects the state fisc. The longer the validity of a tax remains uncertain, the larger the problem the state budget will have to bear should the tax ultimately be found unconstitutional.

The *South Central Bell* case is the most recent and a most frustrating example of the inability of taxpayers to obtain timely and thus adequate remedies for an unconstitutional tax. *South Central Telephone Co. v. Alabama*, 526 U.S. 160 (1999) (question of proper remedy still pending seven years after tax found unconstitutional). This Court ruled in 1999, with no opposition on the merits from the state of Alabama, that Alabama's corporate franchise tax, which had been in existence for approximately 100 years, was unconstitutional as it discriminated against interstate commerce. This Court accepted this case only after denying review of an earlier case on the same issue. Unfortunately for both Alabama and Alabama corporate franchise tax taxpayers, Alabama's budget has not been able to absorb the sheer number of claims for refund (once estimated to equal the entire annual budget of the state) following this Court's invalidation of the tax. As a result, Alabama has never provided full refunds to aggrieved taxpayers. Instead, Alabama has pursued various judicial arguments as to why refunds are not required (notwithstanding its apparent admission in this Court that its tax was unconstitutional) and other procedural delay tactics to prevent taxpayers from receiving a remedy. A prompt review of the present case would prevent states from experiencing fiscal problems that arise when states are permitted to continue plainly unconstitutional taxation over a long period of time.

CONCLUSION

For the reasons stated above, *amici curiae* respectfully request the United States Supreme Court to accept this case for review.

Respectfully submitted,

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